

KellerFurniture

The Keller Manufacturing Company, Inc.

**Annual Report
2001**

TO OUR SHAREHOLDERS

On behalf of our employees, managers, officers and directors, I report to you on fiscal year 2001.

The year 2001 was a very challenging one for Keller and the furniture industry in general. This year we lost \$0.40 a share vs. earning \$0.36 a share in 2000. Our net loss was \$2.3 million vs. a net profit of \$2.0 million in 2000. Our net sales for the year ended December 31, 2001 decreased 22% to \$43.4 million, down from \$55.4 million during the year ended December 31, 2000.

We have historically conducted a physical inventory in the fourth quarter of each year. During the fourth quarter of 2001, we recorded a \$2.8 million after-tax charge for the write down of inventory in accordance with the physical inventory. During the fourth quarter of 2000 we recorded a similar \$0.6 million after-tax charge. The increased write-down in 2001 is attributed to not properly accounting for excess labor and overhead included in inventory as a result of our decision to retain employees despite falling demand and decreasing production in 2001 caused by the recession. To avoid this adjustment in the future, we plan to take a physical inventory count on a quarterly basis and adjust inventory, if necessary. During the fourth quarter of 2001 we also adjusted accrued expenses for sales returns, health claims and vacation time, totaling \$0.8 million in after tax charges.

The reduction of net sales throughout 2001 created difficulty in the timely reduction of costs and expenditures. However, the plans of action that we set forth in 2001 yielded good results. The amount of parts that were discarded because of defects was reduced by 22%. The amount of usable lumber (yield) improved from 48% to 50%. Our budgeted indirect labor was reduced by 17%. On average we delivered furniture to our customers in 28 days or less compared to 56 days on average in 2000. We increased throughput in our Indiana plants and will be implementing lean manufacturing into our Virginia facility in 2002. These improvements were offset by the negative effect of declining net sales. Our manufacturing facilities are now operating at the appropriate level for incoming orders. Our goal is to continue our efforts to implement the lean manufacturing concept throughout 2002.

We ended 2001 with a strong balance sheet, no short or long term debt, and increased cash flow. We bought back 220,000 shares of our common stock over the course of 2001. As future opportunities arise, we will continue to purchase shares according to the three-year, 500,000-share buyback plan authorized by your Board of Directors.

Generating sales is our top priority for 2002. Our strategy is focused on exploiting our three major advantages: 1) Solid wood value; 2) Made in America; and 3) Quality construction. Our order generation plan has many aspects including increased product selection, introducing two new lines of furniture in 2002, increasing our dealer base and the business of our current retailers by implementing in-store solid wood specialty areas, and providing extensive product sales training. We have restructured the sales and marketing management responsibilities along with our field salespeople to place the emphasis on this sales directive for 2002.

The Keller team looks forward to the challenges before us in 2002. We believe 2002 will be a year in which the benefits of our investment in our employees and facilities will take hold.

Visit us at our website www.kellerfurniture.com for other news and information.

Sincerely,



Steven W. Robertson
President/CEO

Management's Discussion and Analysis of Financial Condition and Results of Operations

Certain Items of this Annual Report or Form 10-K (the "Report") contain certain statements that are "forward-looking statements" within the meaning of Section 27A of the Securities Act of and Section 21E of the Securities Exchange Act of 1934, as amended. Those statements appear in a number of places in this Report and may include statements regarding the intent, belief or current expectations of the Company or its officers with respect to (i) the Company's strategic plans, (ii) the policies of the Company regarding capital expenditures, financing and other matters, and (iii) industry trends affecting the Company's financial condition or results of operations. Readers of this Report are cautioned that reliance on any forward-looking statement involves risks and uncertainties. Although The Keller Manufacturing Company, Inc. (the "Company") believes that the assumptions on which the forward-looking statements contained herein are based are reasonable, any of those assumptions could prove to be inaccurate given the inherent uncertainties as to the occurrence or nonoccurrence of future events. There can be no assurance that the forward looking statements contained in this Report will prove to be accurate. The inclusion of a forward-looking statement herein should not be regarded as a representation by the Company that the Company's objectives will be achieved.

Critical Accounting Policies and Estimates

The preparation of our consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts. The estimates and assumptions are evaluated on an on-going basis and are based on historical experience and on various other factors that are believed to be reasonable. Estimates and assumptions include, but are not limited to, allowance for accounts receivables, sales returns, health insurance claims not yet paid and accrued vacation. During the fourth quarter of 2001, the Company adjusted accruals for sales returns, health insurance claims not yet paid and accrued vacation, totaling approximately \$.8 million in after tax charges.

As discussed in Note 1 to the Consolidated Financial Statements, inventories are stated at the lower of cost (first-in, first-out method) or market. The Company's current inventory accounting procedures include the recording of additions to inventory at actual cost and reductions to inventory (i.e. sales) at standard cost.

Management has also implemented the following procedures:

- 1) Record additions to inventory at standard cost.
- 2) Analyze inventory variance accounts on a monthly basis.
- 3) Perform quarterly physical inventory counts.
- 4) Evaluate the reasonableness of standard costs on a quarterly basis, utilizing the actual expenses incurred in the quarter.
- 5) Reconcile inventory per the G/L to the perpetual inventory on a monthly basis.

Results of Operations

The following table sets forth, for the periods indicated, consolidated statements of operations as a percentage of net sales.

		<u>YEAR ENDED DECEMBER 31,</u>		
	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
Net Sales	100.0%	100.0%	100.0%	100.0%
Cost of Sales	89.1%	78.4%	74.7%	72.3%
Gross Profit	10.9%	21.6%	25.3%	27.7%
Selling, General and Administrative	19.0%	15.5%	14.8%	13.2%
Operating Income (Loss)	(8.1%)	6.1%	10.5%	14.5%
Income Before Taxes (Benefit)	(8.1%)	6.1%	11.1%	15.2%
Income Taxes (Benefit)	(2.9%)	2.5%	4.3%	5.8%
Net Income (Loss)	(5.2%)	3.6%	6.8%	9.4%

RECLASSIFICATIONS - Certain Reclassifications have been made to 1998 and 1999 amounts to conform to the 2001 Classifications.

Year Ended December 31, 2001 Compared to Year Ended December 31, 2000

Net Sales. The Company had an approximate 21.7% decrease in net sales in 2001 compared to 2000. This was mostly due to a decrease in orders due to reduced dealer response in a weakening economy.

Orders received in 2001 were down approximately 9.0% from 2000, due to the weak economy of the last fourteen months. This compares to a decrease of approximately 15.0% for the industry.

Cost of Sales. Cost of sales as a percent of net sales increased to 89.1% in 2001 compared to 78.4% in 2000. Actual cost of sales decreased from approximately \$43.4 million in 2000 to approximately \$38.6 million in 2001. In the previous two years, employee turnover resulted in inefficiencies in the manufacturing process, creating higher cost of sales. However, in 2001, the decline in net sales resulted in higher cost of sales as a percent of sales. Employee benefit costs have also continued to increase, largely due to increased health care costs. The Company had health care costs of approximately \$1.6 million in 2001, compared to approximately \$1.4 million in 2000. During 2001, the Company offset rising health care costs by raising employee premiums. Material cost and direct labor cost remained approximately the same as that of 2000.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased in 2001 by approximately \$0.4 million from \$8.7 million in 2000 to \$8.3 million in 2001. The decrease was largely due to a reduction in salesmen commissions which resulted from the decline in sales. As a percent of net sales, selling, general and administrative expenses increased from 15.5% in 2000 to 19.0% in 2001. Selling, general and administrative expenses increased as a percentage of net sales primarily due to the decline in net sales.

Net Income. As a result of the above factors, the net loss for 2001 was approximately \$2.3 million as compared to net income of approximately \$2.0 million in 2000.

Year Ended December 31, 2000 Compared to Year Ended December 31, 1999

Net Sales. The Company had an approximate 0.6% decrease in net sales in 2000 compared to 1999. This was mostly due to an increase in returns and allowances; which increased from 1.85% in 1999 to 3.53% in 2000. Returns and allowances increased partially due to quality issues related to employee turnover and dealer response to a weakening economy.

Orders received in 2000 were down 14.2% from 1999, partially due to delayed shipments during the first six months and partially due to the cooling of the economy the last two months of 2000.

Cost of Sales. Cost of sales as a percent of net sales increased to 78.4% in 2000 compared to 74.7% in 1999. Actual cost of sales increased from approximately \$41.7 million in 1999 to approximately \$43.4 million in 2000. The employee turnover continued throughout the year. This required additional training and continued to result in inefficiencies in the manufacturing process. The inefficiencies have resulted in higher cost of indirect labor, parts loss due to poor quality and higher supervision cost due to an added second shift. The employee benefit costs have also continued to increase, largely due to increased health care costs and worker's compensation costs. The Company agreed to absorb approximately \$.6 million more in increased health care costs rather than raise employee premiums. The worker's compensation cost also increased by approximately \$.2 million compared to 1999 due to an increase in claims. The material cost and direct labor cost remained approximately the same as that of 1999.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased in 2000 by approximately \$.4 million. As a percent of net sales, selling, general and administrative expenses increased from 14.8% in 1999 to 15.5% in 2000. Most of the increase was due to higher cost of bad debts and professional fees. The largest bad debt was Heilig Meyer/Homemaker at approximately \$235,000. The professional fee increase is mostly due to programming cost of the new Information System by Co-Venture.

Net Income. As a result of the above factors, the net income for 2000 was approximately \$2.0 million. This is approximately \$1.8 million less than 1999 income of approximately \$3.8 million.

Liquidity and Capital Resources

The Company's principal source of cash is income from operations. The Company has no material outstanding debt and is not expecting to incur any significant debt in the near future. The cash account has increased over \$2.4 million in 2001 compared to 2000, while accounts receivable decreased approximately \$2.9 million and inventories by approximately \$5.7 million.

The Company's liquidity ratio (cash and cash equivalents plus accounts receivable divided by current liabilities) increased to 2.8 in 2001. This compares to 1.7 in 2000 and 2.22 in 1999. The increase in liquidity ratio was primarily due to a significant decrease of nearly \$2.2 million in current liabilities.

Total capital expenditures for the Company were approximately \$0.6 million and \$2.4 million for 2001 and 2000, respectively. Capital expenditures include purchases of equipment, hardware or software, and expansion of facilities. All capital expenditures for the Company are tracked separately for each of the three locations.

In 2001, Corydon spent approximately \$0.2 million for capital expenditures. The largest expenditures were for a planer sander, tenoner and paint booth filters. Culpeper also spent approximately \$0.2 million for a concrete paint storage area and storage bins. Most of New Salisbury's capital expenditures were for stock assembly layout changes that also totaled approximately \$0.2 million.

In 2000, Corydon spent approximately \$1.0 million in capital expenditures with the Planer/Sander being the largest expenditure at an approximate cost of \$0.3 million. Corydon also purchased a Newman Rough Planer for approximately \$0.2 million. At Culpeper, a molder and profiler grinder cost approximately \$0.3 million which was the largest expenditure out of the approximate \$0.4 million capital expenditure. The largest capital expenditure for the Company and New Salisbury was a warehouse with an approximate cost of \$0.5 million, this was approximately \$0.1 million less than budgeted. Another large capital expenditure was the purchase of a Shoda CNC Machine Center for approximately \$0.3 million.

The product turnover ratio (net sales divided by inventories) increased from 2.8 in 2000 to 3.1 in 2001. This was due to a 21.7 % decrease in net sales and a 29.4% decrease in inventory. There was a reduction in productivity in 2001 due to a slow down in orders as a result of the weak economy.

The Company has had no material short term or long term debt since 1994 compared to 2001's 14.8% industry average of long term debt in relation to net worth in 2000, according to Dun & Bradstreet's Business Scope Report dated January 25, 2002. This has helped the Company maintain its cash flow and liquidity levels. Because of Keller's financial stability, the Company does not currently anticipate the need to issue any new stock other than stock bonus awards or pursuant to the exercise of employee stock options. The Company anticipates funding its growth strategy with cash generated from operations. Construction of a new facility is not currently part of the Company's growth strategy. As mentioned previously, there was an expansion to the New Salisbury warehouse facilities at an approximate cost of \$0.5 million in 2000.

The Company has available lines of credit totaling \$5.0 million. This includes a \$3.0 million line of credit with Union Planters Bank of Corydon, Indiana which expires July 31, 2002. Interest is charged at the prime lending rate. The Company also has a \$2.0 million line of credit available with Bank One of Louisville, Kentucky which expires July 31, 2002. Interest is charged at LIBOR plus 1.5%. These lines are not collateralized. As of December 31, 2001, these lines of credit were unused.

Inflation

The Company believes that it cannot afford to increase prices by a margin much more than the rate of inflation and still remain competitive. The price increase for the years 2000 and 2001 were approximately 2.4% and 2.9%, respectively, with inflation for the same period at 3.4% and 2.8% as reported in the Consumer Price Index. The Company believes that this pricing policy has not had a material adverse effect on its net sales and has contributed to the Company remaining a viable competitor.

To date, the Company believes that the effects of inflation, mostly in health care expenses, have had an effect on its business. The Company recognized approximately \$.6 million in increases in health costs during 2000 and another \$.7 million during 2001. Property, Casualty and Workman's Compensation Insurance premium increases also continue to hurt the bottom line.

Risk Factors

1. Competition

The furniture industry is characterized by highly intense competition. The Company competes with many nationally recognized and financially successful manufacturers of high quality furniture. Many companies with which the Company competes, both domestic and foreign, have substantially larger production capacities, distribution networks and greater financial resources than the Company.

The furniture industry is a segmented industry whereby design, quality and price place each manufacturer into one or more competitive market niches. The Company competes in the middle to upper-middle price market, which normally requires a larger number of items in the product line, smaller production lot sizes and higher inventory requirements to maintain a competitive delivery cycle. Certain of the Company's competitors may have greater financial and other resources than the Company in particular industry segments. Competition could materially adversely affect the Company's operating results by forcing it to reduce its sales prices, offer enhanced credit terms, increase customer discounts or incentives, increase spending for co-operative advertising arrangements with customers or provide other services.

2. Industry Conditions.

The furniture industry historically has been cyclical, with operating results fluctuating sharply with the business cycle of the national economy. During economic downturns, the furniture industry tends to experience longer periods of recession and greater declines than does the general economy. The Company believes that the industry is influenced significantly by economic conditions generally and more specifically by consumer behavior and confidence, the level of personal discretionary spending, housing activity, interest rates and credit availability. These factors affect not only the ultimate consumer, but also furniture retailers, the industry's primary direct customers. The cyclical nature of the industry has contributed historically to fluctuations in the Company's results of operations, and such fluctuations can be expected to occur in the future.

3. Employee Turnover.

The Company experienced unusually high employee turnover during 1999 which continued into the third quarter of 2000. This caused inefficiencies in the manufacturing process and contributed to higher cost of sales. With the slowdown in the economy, we have noticed a decrease in employee turnover for 2001. While the Company has also implemented programs to address issues raised by employee turnover, there can, however, be no guarantee that the Company will not experience significant employee turnover in the future which could materially adversely affect the Company's financial condition, results of operations and prospects.

4. Governmental Regulations and Environmental Considerations.

The Company's operations must meet extensive federal, state and local regulatory standards in the areas of safety, health and environmental pollution controls. Historically, these standards have not had a material adverse effect on the Company's sales or operations. Under the provisions of the Clean Air Act Amendments of 1990 (the "CAA"), in December 1995, the United States Environmental Protection Agency promulgated hazardous air emission standards for the wood furniture industry. These regulations, known as the National Emission Standards for Hazardous Air Pollutants ("NESHAPs"), require the Company to reduce emissions of certain volatile organic compounds. Procedural and record keeping improvements have been put in place to prevent air quality violations. Other environmental projects completed in 2001 include construction of a finish material storage structure at the Culpeper plant and installation of improved monitoring equipment on the New Salisbury sewage treatment plant. The Company expects these regulations to become even more stringent in the future and cannot predict the costs of effects on its operations which will result from its compliance with these regulations.

5. Fluctuations in Price and Supply of Raw Materials.

The Company is dependent upon outside suppliers for all of its raw material needs and, therefore, is subject to price increases and delays in receiving supplies of such materials. An increase in demand for raw materials could increase delivery times for supplies and possibly further affect prices. No assurance can be given that the Company will continue to have available necessary raw materials at a reasonable price or that any increases in raw material costs would not have a material adverse effect on the Company.

6. Potential Stock Price Volatility.

Currently there is one brokerage firm, Hilliard, Lyons, Inc. in Louisville, Kentucky, making a market in the Company's Common Shares. There can be no guarantee that this firm will continue to make a market in the Company's Common Shares, nor can there be any assurances that an active trading market will develop or be sustained in its absence.

The market price of the Company's Common Shares has experienced some significant fluctuations in response to variations in operating results from quarter to quarter, changes in earnings estimates by analysts, market conditions in the industry and general economic conditions. Furthermore, the stock market has experienced significant price and volume fluctuations unrelated to the operating performance of particular companies. These market fluctuations may have a material adverse effect on the market price of the Company's Common Shares.

7. Dividend Policy.

The Board of Directors has traditionally approved four (4) cash dividends per year to holders of its Common Shares. The amount of these dividends for 2000 and 2001 is reflected in Market Price and Dividends on the Registrants Common Equity and Related Stockholder Matters, below. The Board of Directors, however is not bound in any manner to continue such dividends. Any future determination as to the payment of dividends will be made at the discretion of the Board of Directors and will depend upon the Company's operating results, financial condition, capital requirements, general business conditions and such other factors as the Board of Directors deems relevant.

Market Price and Dividends on the Registrants Common Equity and Related Stockholder Matters

The Company's Common Stock has been traded on the NASDAQ Stock Market over-the-counter bulletin board (OTC:BB) through Hilliard, Lyons, Inc. in Louisville, Kentucky. The following prices have been provided by Hilliard, Lyons, Inc. based upon actual trades (selling price during the applicable period). As of December 31, 2001, there were 481 record shareholders of Keller Common Stock.

	1 st Qtr		2 nd Qtr.		3 rd Qtr.		4 th Qtr.	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
2001	3.750	3.380	3.720	3.250	3.700	3.150	3.150	2.620
2000	6.125	4.438	6.00	4.375	4.13	3.38	3.75	3.06

	Quarterly Dividends Per Share				
	<u>1st Qtr</u>	<u>2nd Qtr.</u>	<u>3rd Qtr.</u>	<u>4th Qtr.</u>	<u>Total</u>
2001	.035	.035	.035	.035	.14
2000	.035	.035	.035	.035	.14

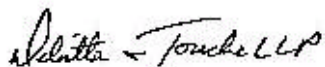
INDEPENDENT AUDITOR'S REPORT

Board of Directors
The Keller Manufacturing Company, Inc. and Subsidiary
Corydon, Indiana

We have audited the accompanying consolidated balance sheets of The Keller Manufacturing Company, Inc. and subsidiary (the Company) as of December 31, 2001 and 2000, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of the The Keller Manufacturing Company, Inc. and subsidiary as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America.



February 15, 2002
Louisville, Kentucky

THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

December 31, 2001 and 2000

	2001	2000
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$2,591,312	\$406,186
Accounts receivable, less allowance for doubtful accounts of \$287,000 (2001) and \$221,000 (2000)	5,477,814	8,396,438
Inventories	13,826,149	19,575,157
Current deferred tax asset	527,210	621,146
Income taxes receivable	1,576,296	--
Other current assets	158,016	163,600
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Total	24,156,797	29,162,527
PROPERTY, PLANT AND EQUIPMENT - net	10,050,750	10,898,743
PREPAID PENSION COSTS	1,775,509	1,851,928
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TOTAL	<u>\$35,983,056</u>	<u>\$41,913,198</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$524,919	\$1,575,979
Commissions, salaries and withholdings	513,127	926,208
Accrued vacation	643,699	486,881
Income taxes payable	--	259,051
Allowance for sales returns	245,000	956,903
Other current liabilities	994,439	963,421
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Total	2,921,184	5,168,443
LONG TERM LIABILITIES -		
Deferred tax liability	1,267,005	1,337,312
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Total	4,188,189	6,505,755
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Common stock - no par value, authorized, 40,000,000 shares	1,746,646	1,728,513
Retained earnings	30,048,221	33,678,930
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Total	31,794,867	35,407,443
TOTAL	<u>\$35,983,056</u>	<u>\$41,913,198</u>

See notes to consolidated financial statements.

THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2001, 2000 AND 1999

	2001	2000	1999
NET SALES	\$43,363,064	\$55,391,644	\$55,751,215
COST OF SALES	<u>38,649,281</u>	<u>43,406,132</u>	<u>41,670,927</u>
GROSS PROFIT	4,713,783	11,985,512	14,080,288
SELLING, GENERAL AND ADMINISTRATIVE	<u>8,316,758</u>	<u>8,724,051</u>	<u>8,282,022</u>
OPERATING INCOME (LOSS)	(3,602,975)	3,261,461	5,798,266
OTHER INCOME (EXPENSE):			
Interest income	33,490	92,593	153,692
Interest expense	(14,371)	(52,956)	(571)
Other	<u>56,727</u>	<u>103,037</u>	<u>206,876</u>
Other income, net	<u>75,846</u>	<u>142,674</u>	<u>359,997</u>
INCOME (LOSS) BEFORE INCOME TAXES	(3,527,129)	3,404,135	6,158,263
INCOME TAXES (BENEFIT)	<u>(1,276,718)</u>	<u>1,382,046</u>	<u>2,377,494</u>
NET INCOME (LOSS)	<u>(\$2,250,411)</u>	<u>\$2,022,089</u>	<u>\$3,780,769</u>
NET INCOME (LOSS) PER SHARE OF COMMON STOCK, basic and dilutive - based on weighted average number of shares outstanding of 5,565,780 (2001), 5,611,354 (2000), and 5,753,211 (1999)	<u>(\$0.40)</u>	<u>\$0.36</u>	<u>\$0.66</u>

See notes to consolidated financial statements.

THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY YEARS ENDED DECEMBER 31, 2001, 2000 AND 1999

	<u>Common Stock</u>		Retained <u>Earnings</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>		
BALANCE, JANUARY 1, 1999	5,851,767	\$ 1,437,276	\$ 31,695,113	\$ 33,132,389
Net Income			3,780,769	3,780,769
Cash dividends declared (\$.18 per share)			(802,045)	(802,045)
Stock issued as awards	2,600	26,000		26,000
Stock issued under employee incentive plan	28,166	281,660		281,660
Redemptions of common stock	<u>(263,170)</u>	<u>(32,298)</u>	<u>(2,170,467)</u>	<u>(2,202,765)</u>
BALANCE, DECEMBER 31, 1999	5,619,363	1,712,638	32,503,370	34,216,008
Net Income			2,022,089	2,022,089
Cash dividends declared (\$.14 per share)			(787,030)	(787,030)
Stock issued under employee incentive plan	2,863	17,357		17,357
Redemptions of common stock	<u>(12,069)</u>	<u>(1,482)</u>	<u>(59,499)</u>	<u>(60,981)</u>
BALANCE, DECEMBER 31, 2000	5,610,157	1,728,513	33,678,930	35,407,443
Net Loss			(2,250,411)	(2,250,411)
Cash dividends declared (\$.14 per share)			(781,052)	(781,052)
Stock issued as awards	1,000	3,380		3,380
Stock issued under employee incentive plan	22,954	77,585		77,585
Redemptions of common stock	<u>(220,000)</u>	<u>(62,832)</u>	<u>(599,246)</u>	<u>(662,078)</u>
BALANCE, DECEMBER 31, 2001	<u>5,414,411</u>	<u>\$1,746,646</u>	<u>\$30,048,221</u>	<u>\$31,794,867</u>

See notes to consolidated financial statements.

THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2001, 2000 AND 1999

	2001	2000	1999
OPERATING ACTIVITIES:			
Net income (loss)	\$ (2,250,411)	\$ 2,022,089	\$ 3,780,769
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Gain on sale of property, plant, and equipment	(10,000)	(600)	--
Depreciation	1,471,428	1,589,293	1,655,277
Deferred income taxes	23,629	(378,119)	268,764
Common stock awards	80,965	17,357	307,660
Changes in assets and liabilities:			
Accounts receivable	2,918,624	(1,736,958)	(374,963)
Inventories	5,749,008	(1,881,725)	(1,626,942)
Income taxes receivable/payable	(1,835,347)	689,496	(151,583)
Other current assets	5,584	(81,712)	455,036
Prepaid pension costs	76,419	(16,593)	(74,576)
Accounts payable	(1,051,060)	(94,370)	(154,994)
Commissions, salaries and withholdings and accrued vacation	(256,263)	(155,297)	(449,532)
Allowance for sales returns	(711,903)	956,903	
Other current liabilities	31,018	(73,675)	(373,245)
Net cash provided by operating activities	4,241,691	856,089	3,261,671
INVESTING ACTIVITIES:			
Purchases of property, plant and equipment	(623,435)	(2,442,734)	(1,902,405)
Proceeds from sale of property, plant and equipment	10,000	600	
Sale of investment security available-for-sale			500,000
Net cash used in investing activities	(613,435)	(2,442,134)	(1,402,405)
FINANCING ACTIVITIES:			
Redemptions of common stock	(662,078)	(60,981)	(2,202,765)
Dividends paid	(781,052)	(787,030)	(802,045)
Net cash used in financing activities	(1,443,130)	(848,011)	(3,004,810)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	2,185,126	(2,434,056)	(1,145,544)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	406,186	2,840,242	3,985,786
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 2,591,312	\$ 406,186	\$ 2,840,242
CASH PAID DURING THE YEAR FOR:			
Interest	\$ 11,000	\$ 52,000	\$ --
Income Taxes	\$ 535,000	\$ 1,131,000	\$ 2,241,000

See notes to consolidated financial statements.

THE KELLER MANUFACTURING COMPANY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED DECEMBER 31, 2001, 2000 AND 1999

1. BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Business - The Company operates in one business segment, which is the manufacturing of dining room and bedroom furniture. Sales are made to retailers located in approximately 30 states across the United States on an unsecured basis.

Basis of Presentation - The consolidated financial statements include the accounts of The Keller Manufacturing Company, Inc. and its wholly-owned subsidiary, Keller Dedicated Transportation Company. All significant intercompany transactions and balances have been eliminated.

Significant Customers - The Company had one significant customer, which accounted for approximately \$6,307,000 (15%), \$8,592,000 (16%), and \$8,851,000 (16%) of net sales and percentage of total net sales in 2001, 2000 and 1999, respectively. At December 31, 2001, 2000 and 1999, accounts receivable from the significant customer totaled approximately \$781,000, \$1,355,000 and \$1,070,000, respectively.

Cash and Cash Equivalents - Cash and cash equivalents is defined as cash in banks and investment instruments having maturities of three months or less from their acquisition date.

Inventories - Inventories are stated at the lower of cost (first-in, first-out method) or market.

Property, Plant, and Equipment - Property, plant, and equipment are recorded at cost. Depreciation is provided by the straight-line method over the estimated useful lives of the depreciable assets. Estimated lives are 10-45 years for buildings and leasehold improvements, 3-20 years for land improvements and 3-15 years for machinery and equipment.

Revenue Recognition - Sales are recorded when goods are delivered to the customer. The Company provides for estimated customer returns and allowances by reducing sales in the period of the sale.

Shipping Costs - Shipping costs are recorded in cost of sales.

Research, Development, and Engineering - Research, development, and engineering expenditures for the creation and application of new and improved products and manufacturing processes were approximately \$380,000 in 2001, \$370,000 in 2000 and \$670,000 in 1999. Research, development and engineering costs are charged to operations as incurred.

Income Taxes - The Company follows Statement of Financial Accounting Standards (SFAS) No. 109 "Accounting for Income Taxes," which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the consolidated financial statements or income tax return.

Fair Value of Financial Instruments - The fair values of the Company's current assets and current liabilities approximate their reported carrying values, due to their short-term maturities.

Recent Accounting Pronouncements - In August 2001, the Financial Accounting Standards Board (FASB) issued Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This Statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The Company will adopt this statement effective January 1, 2002. Management has concluded that the adoption of this statement will not have a material effect on the Company's financial position, results of operations, or cash flows.

In June 2001, the FASB issued Statement No. 141, "Business Combinations," and Statement No. 142, "Goodwill and Other Intangible Assets." These statements require the use of the purchase method to account for all business combinations and broaden the criteria for recording acquired intangible assets separate from goodwill. The statements also do not allow goodwill or intangible assets with indefinite lives, such as trademarks, to be amortized and require companies to test goodwill for impairment as least annually. The Company will adopt these statements effective January 1, 2002. Management has concluded that the adoption of these statements will not have a material effect on the Company's financial position, results of operations or cash flows.

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," establishes accounting and reporting standards for hedging activities and for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives). Under SFAS 133, certain contracts that were not formerly considered derivatives may now meet the definition of a derivative. The Company adopted SFAS 133 effective January 1, 2001. The Company determined that with the adoption of this new standard, there was no material impact on its financial position or results of operations.

Disclosure of Certain Significant Risks and Uncertainties - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The Company's periodic filings with the Securities and Exchange Commission include, where applicable, disclosures of estimates, assumptions, uncertainties and concentrations in products, sources of supply and markets that affect the consolidated financial statements and future operations of the Company.

2. INVENTORIES

	<u>2001</u>	<u>2000</u>
Raw Materials	\$4,563,468	\$6,869,777
Work-in-process	6,126,523	8,901,915
Finished Goods	3,046,158	3,803,465
Net Inventories	<u>\$13,826,149</u>	<u>\$19,575,157</u>

3. PROPERTY, PLANT AND EQUIPMENT

	2001	2000
Land	\$ 337,535	\$ 337,535
Land improvements	876,528	792,663
Buildings and leasehold improvements	8,016,808	7,923,514
Machinery and equipment	15,084,334	14,708,617
Construction in progress	<u>72,282</u>	<u>29,998</u>
Total	24,387,487	23,792,327
Less accumulated depreciation	<u>(14,336,737)</u>	<u>(12,893,584)</u>
Net	<u>\$ 10,050,750</u>	<u>\$ 10,898,743</u>

4. LINES OF CREDIT

At December 31, 2001, the Company had unsecured line of credit agreements that provide for borrowings up to an aggregate of \$5,000,000, with variable interest rates based on prime rate of 4.75% at December 31, 2001, or 1.5% in excess of the LIBOR rate of 2.44% at December 31, 2001. There were no borrowings on the line of credit agreements at December 31, 2001 and 2000.

5. INCOME TAXES

Income tax expense (benefit) consists of:

	2001	2000	1999
Currently payable (receivable):			
Federal	\$ (1,138,788)	\$ 1,569,882	\$ 2,016,918
State	<u>(161,559)</u>	<u>190,283</u>	<u>91,812</u>
Total currently payable	<u>(1,300,347)</u>	<u>1,760,165</u>	<u>2,108,730</u>
Deferred:			
Federal	30,047	(471,910)	249,950
State	<u>(6,418)</u>	<u>93,791</u>	<u>18,814</u>
Total deferred	<u>(23,629)</u>	<u>(378,119)</u>	<u>268,764</u>
Total	<u>\$ (1,276,718)</u>	<u>\$ 1,382,046</u>	<u>\$ 2,377,494</u>

The state income tax expense for 1999 includes refunds of prior years state taxes paid. The tax effect of temporary differences that give rise to significant portions of the net deferred tax liability at December 31 are as follows:

	2001	2000
Deferred tax current assets:		
Allowance for sales returns	\$ 93,970	\$ 371,987
Accrued vacation	200,185	150,397
Allowance for doubtful accounts	110,319	85,961
Other	<u>122,736</u>	<u>12,801</u>
Total deferred tax current assets	<u>\$ 527,210</u>	<u>\$ 621,146</u>
Deferred tax noncurrent assets -		
Other	<u>\$ 54,929</u>	<u>\$ 31,889</u>
Deferred tax long-term liabilities:		
Pension costs	680,998	719,920
Depreciation	578,734	457,018
Other	<u>62,202</u>	<u>192,263</u>
Total deferred tax long-term liabilities	<u>1,321,934</u>	<u>1,369,201</u>
Net deferred tax noncurrent liabilities	<u>\$ 1,267,005</u>	<u>\$ 1,337,312</u>

The difference between taxes computed at the federal statutory tax rate and the Company's effective tax rate are as follows:

	2001	2000	1999
Statutory federal income tax rate	34.0%	34.0%	34.0%
State taxes, net of federal income tax benefit	2.9	5.6	5.0
Other	<u>(0.7)</u>	<u>1.0</u>	<u>(0.4)</u>
Effective income tax rate	<u>36.2%</u>	<u>40.6%</u>	<u>38.6%</u>

6. PENSION PLANS

The Company has a defined benefit plan that provides retirement benefits for substantially all employees. Annual contributions to the plan are sufficient to satisfy legal funding requirements. The changes in benefit obligations and plan assets, as well as the funded status of the plan at December 31, 2001 and 2000 were as follows:

	2001	2000
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 11,459,375	\$ 11,076,425
Service cost	385,009	395,226
Interest cost	838,227	809,897
Benefits paid	(974,665)	(556,891)
Actuarial (gain) loss	289,867	(265,282)
Benefit obligation at the end of year	<u>\$ 11,997,813</u>	<u>\$ 11,459,375</u>
Change in plan assets:		
Fair value of plan assets at the beginning of year	\$ 10,992,239	\$ 10,988,323
Actual return on plan assets	371,688	132,033
Employer contributions	420,138	428,774
Benefits paid	(974,655)	(556,891)
Fair value of plan assets at the end of year.	<u>\$ 10,809,410</u>	<u>\$ 10,992,239</u>
Funded status	\$ (1,188,403)	\$ (467,136)
Unrecognized net actuarial loss	2,985,144	2,370,856
Unrecognized prior service cost	(21,232)	(37,881)
Unrecognized net asset	-	(13,911)
Prepaid pension cost	<u>\$ 1,775,509</u>	<u>\$ 1,851,928</u>

The following weighted-average assumptions were used to determine the Company's obligations under the plan:

Weighted-average assumptions as of December 31:

Discount rate	7.25%	7.50%
Expected return on plan assets	7.50%	7.50%
Rate of compensation increase	3.50%	3.50%

The components of net pension expense are as follows:

	2001	2000	1999
Components of net periodic benefit cost:			
Service cost - benefits earned during the year	\$ 385,009	\$ 395,226	\$ 442,270
Interest cost on projected benefit obligation	838,227	809,897	794,068
Expected return on plan assets	(796,761)	(799,399)	(882,312)
Net amortization and deferral	70,082	6,457	12,190
Net pension expense	<u>\$ 496,557</u>	<u>\$ 412,181</u>	<u>\$ 366,216</u>

The Company has implemented a defined contribution savings plan under the provisions of Section 401(k) of the Internal Revenue Code that provides retirement benefits to substantially all employees. The Company's contribution, which is based upon the salary redirection contributions of the eligible employees, totaled approximately \$23,000, \$30,000 and \$38,000 in 2001, 2000 and 1999, respectively.

7. LEASE COMMITMENTS

The Company has operating lease agreements for marketing showroom and trucking equipment. The equipment lease requires additional rentals based upon miles driven at varying fixed rates per mile and requires the Company to pay for maintenance, tires, taxes, licenses and permits.

Minimum annual rental payments are as follows:

Year Ended	
December 31	
2002	\$ 801,261
2003	752,803
2004	617,691
2005	376,697
2006	53,761
2007 and thereafter	<u>52,153</u>
Total	<u>\$ 2,654,366</u>

Total rental expense was approximately \$815,000 (including \$111,000 of contingent rentals) for 2001, \$843,000 (including \$127,000 of contingent rentals) for 2000 and \$851,000 (including \$136,000 of contingent rentals) for 1999.

8. EMPLOYEE INCENTIVE AND AWARD PROGRAMS

The Company has incentive programs for executives and key middle management personnel. The programs provide for payment of profit sharing in cash and common stock in amounts not to exceed 12% of the annual pre-tax profits of the Company before interest expense and incentive expense. As the Company experienced a net loss in 2001 there was no profit sharing accrued. The profit sharing accrued for 2000, and 1999 was approximately \$457,000 and \$815,000, respectively, which represents the fair value of 22,954 (2000) and 2,863 (1999) shares of common stock and the cash incentive.

Additionally, the Company has award programs which involve the distribution of common stock to employees based on outstanding service. The cost of these awards for 2001 and 1999 was approximately \$3,000 and \$26,000, respectively, which represents the fair value of 1,000 (2001) and 2,600 (1999) shares of common stock issued. No such awards were given in 2000.

9. EMPLOYEE HEALTH PLAN

The Company has a medical indemnity plan providing comprehensive major medical benefits for eligible employees and members of their immediate families (participants) and is subject to the provisions of the Employee Retirement Income Security Act of 1974. The Company's contribution, which is based upon the contributions of currently employed participants and any additional amounts required to pay benefits for participants, totaled approximately \$1,491,000, \$1,322,000 and \$756,600 in 2001, 2000, and 1999, respectively.

10. STOCK OPTION PLAN

In January 1999, a stock option plan for eligible employees was approved by the Company. Under the terms of the plan, the Company is authorized to grant options of common shares, not to exceed 200,000 shares, to eligible employees and members of the Board of Directors. Options outstanding are generally exercisable immediately upon grant date. All options expire four years after the date of the grant.

The following is a summary of the option transactions under the plan:

	Shares	Weighted average exercise per share
Granted in 1999	34,700	\$ 8.00
Forfeited	<u>(850)</u>	8.00
Balance at December 31, 1999	33,850	8.00
Granted	32,800	3.50
Forfeited	<u>(2,700)</u>	7.50
Balance at December 31, 2000	63,950	5.72
Granted	31,700	3.00
Forefeited	<u>(6,100)</u>	5.43
Balance at December 31, 2001	<u><u>89,550</u></u>	4.78

A total of 84,300, 58,450 and 28,350 shares at an average option price per share of \$4.89, \$5.93 and \$8.00 were exercisable at December 31, 2001, 2000 and 1999, respectively. At December 31, 2001, 110,450 shares were available for future grants.

In 2001, 89,550 stock options were excluded from the computation of diluted earnings per share due to their antidilutive effect.

The following table summarizes information about stock options outstanding at December 31, 2001:

Options outstanding			Options Exercisable	
Exercise Price	Number Outstanding at 12/31/2001	Remaining Contractual Life (Years)	Exercise Price	Number Exercisable at 12/31/2001
\$8.00	28,950	1.70	\$8.00	28,950
\$3.50	29,200	2.71	\$3.50	29,200
\$3.00	31,400	3.71	\$3.00	26,150

The weighted average fair value of options granted during 2001, 2000 and 1999 was \$.99, \$1.95 and \$3.75, respectively.

The fair value of each stock option grant was estimated as of the date of the grant using the Black-Scholes option-pricing model with the following assumptions for 2001, 2000 and 1999, respectively: quarterly dividend yield of 1%, 1% and .44%; volatility factor of 40%, 68% and 43%; risk-free interest rate of 3.75%, 6.0% and 6.6%; and expected life of 4 years for all years.

In accordance with Accounting Principle Board No. 25, "Accounting for Stock Issued to Employees", the Company has not recognized any compensation cost for the stock option plan. Had compensation cost for the Company's stock option plan been determined based on the fair value at the grant date for awards under the plan consistent with the method of SFAS No. 123, "Accounting for Stock-Based Compensation," the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

		2001	2000	1999	
Net Income (loss)	As reported	\$ (2,250,411)	\$ 2,022,089	\$ 3,780,769	
	Pro forma	\$ (2,281,867)	\$ 1,958,005	\$ 3,653,864	
Earnings (loss) per share	As reported	\$ (0.40)	\$ 0.36	\$ 0.66	
	Pro forma	\$ (0.41)	\$ 0.35	\$ 0.64	

The effects of applying SFAS 123 in this pro forma disclosure are not indicative of future amounts.

11. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

	Three months ended				Total
	Mar. 31, 2001	June 30, 2001	Sept. 30, 2001	Dec. 31, 2001	
For the year ended December 31, 2001					
Net sales	\$ 11,459,954	\$ 10,943,962	\$ 11,674,459	\$ 9,284,689	\$ 43,363,064
Gross profit (loss)	2,555,772	2,787,183	3,158,112	(3,787,284)	4,713,783
Net income (loss)	364,826	524,906	651,769	(3,791,912)	(2,250,411)
Net income (loss) per common share					
basic and dilutive	0.06	0.09	0.12	(0.67)	(0.40)
Dividends per common share	0.035	0.035	0.035	0.035	0.14
	Three months ended				
	Mar. 31, 2000	June 30, 2000	Sept. 30, 2000	Dec. 31, 2000	Total
For the year ended December 31, 2000					
Net sales	\$ 14,682,577	\$ 14,941,529	\$ 13,147,371	\$ 12,620,167	\$ 55,391,644
Gross profit	3,453,310	3,699,866	3,299,261	1,533,075	11,985,512
Net income (loss)	821,536	884,801	616,411	(300,659)	2,022,089
Net income (loss) per common share					
basic and dilutive	0.15	0.16	0.11	(0.06)	0.36
Dividends per common share	0.035	0.035	0.035	0.035	0.14

During the fourth quarter of 2001, the Company recorded a charge of approximately \$4.3 million (\$2.8 million after tax) for the write down of inventory as a result of a physical inventory count conducted during the fourth quarter. The Company also adjusted accruals for sales returns, health insurance claims not yet paid and accrued vacation, totaling approximately \$1.3 million (\$0.8 million after tax). The Company is unable to determine the impact, if any, of the write down of inventory and other charges to previous quarters and accordingly, has recorded the amounts in the fourth quarter of 2001.

CORPORATE DATA

CORPORATE HEADQUARTERS

701 N. WATER ST.
CORYDON, IN 47112

PRODUCTION FACILITIES

701 NORTH WATER ST., CORYDON, IN 47112
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ICE MILLER LEGAL & BUSINESS ADVISORS
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TRANSFER AGENT

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AUDITORS

DELOITTE & TOUCHE LLP
Louisville, KY

THE KELLER MANUFACTURING COMPANY, INC.

BOARD OF DIRECTORS AND OFFICERS

Robert W. Byrd
Chairman of the Board

Steven W. Robertson
President and Chief Executive Officer

Marvin C. Miller
Chief Operating Officer

Danny L. Utz
Vice President of Finance,
Secretary and Treasurer

Scott A. Armstrong
Sr. Vice President of Sales and
Marketing

EXECUTIVE OFFICERS

John Heishman
Vice President of Manufacturing

David Jenkins
Vice President of Engineering

Keith R. Meriwether
Vice President of Sales and
Marketing

BOARD OF DIRECTORS

John C. Schenkenfelder
First Vice President of Investments
UBS Paine Webber, Inc.

Bradford T. Ray
Vice Chairman and Chief Executive
Officer
Steel Technologies, Inc.

Ronald W. Humin
Chief Executive Officer
Flexible Materials, Inc.

Philip L. Jacobs
President
Evans Furniture Showrooms

Form 10-K

A copy of the Company's Form 10-K Annual Report, filed with the Securities and Exchange Commission, is available upon written request to Danny L. Utz at The Keller Manufacturing Company, Inc., P.O. Box 8, Corydon, Indiana, 47112. The 10-K and 10-Q reports can also be accessed on the Internet at **<http://www.freedgar.com>**

KellerFurniture

The Keller Manufacturing Company, Inc.